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Ratings

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Summary:
Forest Hills Borough, Pennsylvania; General Obligation

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Long Term Rating	AA/Stable	Outlook Revised

Rating Action

S&P Global Ratings has revised the outlook on Forest Hills Borough, Pa.'s outstanding general obligation (GO) bonds to stable from negative and affirmed its 'AA' rating on the borough's debt.

The borough's outstanding bonds are secured by its GO pledge that benefits from an ad valorem property tax unlimited by rate or amount.

Credit overview

The stable outlook reflects Forest Hills Borough's very strong reserve position and our expectation that it will maintain those strong reserves due to conservative budgeting practices over our outlook horizon, which is generally up to two years. The borough benefits from its location in the Pittsburgh metropolitan statistical area (MSA); it is about seven miles east of downtown. During fiscal 2020 (Dec. 31 year-end), its earned income and local services tax, which are most sensitive to economic cycles, came in higher than budget. We attribute the healthy revenue performance to attenuated COVID-19-related effects, especially to higher wage individuals, as well as management's conservative budgeting. The borough has a strong history of balanced general fund performance. Prior to 2020, it drew down its reserves for one-time capital contributions toward the construction of its administration building. Management does not expect any additional one-time draws for capital. The borough also benefits from a favorable liability profile with rapidly amortizing debt and single-employer pension plans with strong funded ratios.

The rating reflects our opinion of the following factors for the borough, including its:

- Strong economy, with access to a broad and diverse MSA;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 22% of operating expenditures;
- Very strong liquidity, with total government available cash at 66.6% of total governmental fund expenditures and 8.5x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability profile, with debt service carrying charges at 7.8% of expenditures and net direct

debt that is 67.4% of total governmental fund revenue, as well as rapid amortization, with 76.0% of debt scheduled to be retired in 10 years; and

- Strong institutional framework score.

Environmental, social, and governance factors

We consider the borough's environmental, social, and governance (ESG) risk as meeting the sector standard. Some homes within the borough sustained inland flooding due to extreme rain from Hurricane Ida; however, there was no damage to borough properties and management does not anticipate any material financial affects related to storm clean-up. Forest Hills is also part of a consent decree with the U.S. Environmental Protection Agency (EPA) and the Pennsylvania Department of Environmental Protection to address storm water runoff and sewer overflows. We view the borough as having slightly elevated physical environmental risk compared to the sector standard, but we view the risk as mitigated given that management is budgeting for and addressing the issues covered by the consent decree. Additionally, Forest Hills adopted a local Climate Action Plan in 2020 with the goals of reducing emissions and waste, as well as improving water and wastewater management.

Stable Outlook

Downside scenario

If Forest Hills' available reserves were to decline to levels we no longer consider very strong, we could lower the rating.

Upside scenario

If the borough's wealth indicators were to improve to levels commensurate with those of higher rated peers and its general fund balance were to nominally increase, we could raise the rating.

Credit Opinion

Strong economy

We consider Forest Hills' economy strong. The borough, with a population of 6,336, is in Allegheny County in the Pittsburgh MSA, which we consider to be broad and diverse. It has a projected per capita effective buying income of 130% of the national level and per capita market value of $55,733. Overall, market value grew by 2.4% over the past year to $353.1 million in 2020. The county unemployment rate was 9.0% in 2020; however, as of July 2021, it has fallen to 6.3%. In our view, Forest Hills Borough's economy has remained better on average than the county. Additionally, S&P Global Economics indicates that the national economic outlook continues to improve (see "Economic Outlook U.S. Q3 2021: Sun, Sun, Sun, Here It Comes," published June 24, 2021, on RatingsDirect).

Forest Hills residents benefit from access to the Pittsburgh and Allegheny County employment bases, resulting in strong per capita incomes. Many residents work in health care, education, and government, with leading employers in the county including University of Pittsburgh Medical Center, University of Pittsburgh, and the federal government. In 2013, Allegheny County underwent a countywide reassessment which substantially increased property values. As a result, assessed values (AVs) declined 2014 through 2017 as residents appealed their assessments. However, more recently appreciation of properties has outpaced any appeals activity. The borough is nearly completely built-out, so we do not expect significant new development, but we anticipate some redevelopment projects.

Strong management

We view the borough's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

The borough uses ten years of historical data when developing the budget and the board receives monthly update statements with budget-to-actuals which includes investment holdings. It also has a five-year capital improvement plan that is updated annually and identifies costs of all projects but not necessarily the funding sources. The borough has a policy to maintain a minimum budget reserve of 5% of budget and maximum of 10%, with an average of 7%, which it is currently meeting. If it were to draw on its budget reserve, the policy instructs that it should be replenished within two years. Forest Hills does not have a formalized debt management policy, nor does it conduct long term financial planning, though it does a budget plus a one-year plan. Additionally, the borough has plans and processes in place to prevent and mitigate cyberattacks.

Strong budgetary performance

Forest Hills' budgetary performance is strong, in our opinion. The borough had operating surpluses of 2.7% of expenditures in the general fund and 7.0% across all governmental funds in fiscal 2020. We adjusted general fund expenditures to account for recurring transfers to other funds. After adjustments, the borough has demonstrated strong general fund performance over the last several years.

The fiscal 2021 general fund budget is break-even, and year to date management reports that revenue is tracking slightly better than budget and expenditures are in line with expectations. As a result, there will likely be a small general fund surplus. The borough received $329,603 in American Rescue Plan Act (ARPA) funds in 2021 and will receive the same amount in 2022. At this time, management expects it will be used for one-time expenditures related to sanitary and storm sewer improvements.

During fiscal 2020, the borough made slight adjustments to expenditures, though many reductions were pandemic-induced, such as closing its swimming pool. It incurred some increased costs for items such as personal protective equipment (PPE) and cleaning supplies, but these were largely reimbursed by federal funds. The borough's revenues largely performed stronger than expected, which led to the surplus.

The borough's main general fund revenue sources consist of property taxes (48% of 2020 revenue on a budgetary basis), earned income tax (18%), charges for services (15%), intergovernmental (7%), and Regional Asset District (RAD) sales tax (4%) revenue. It has kept its property tax rate the same at 8 mills since 2013 and does not have any plans to increase its millage at this time. Given that the borough is mostly property tax dependent, and it has a history of outperforming budget even during the recent pandemic, we believe performance is likely to remain strong.

Very strong budgetary flexibility

Forest Hills' budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 22% of operating expenditures, or $1.2 million. We have adjusted the borough's available fund balance to include the committed balance that is designated for budgetary reserve. Management intends to maintain 7% of budget committed for budgetary reserve. In addition, we have reduced the general fund available balance for $492,000 of questionable receivables due to the general fund. Management does not expect declines in its general fund balance or increases in receivables.

Very strong liquidity

In our opinion, Forest Hills' liquidity is very strong, with total government available cash at 66.6% of total governmental fund expenditures and 8.5x governmental debt service in 2020. In our view, the borough has strong access to external liquidity if necessary.

We have adjusted the borough's available cash to remove $382,000 of cash in the liquid fuels fund that we do not believe would be available for cash-flow purposes. Forest Hills has demonstrated strong access to external liquidity through regular debt issuances. We do not view the borough's investments as aggressive, as it primarily invests in mutual funds, the Pennsylvania INVEST Program, and the Pennsylvania Local Government Investment Trust (PLGIT). It does not have any contingent liquidity risk direct-purchase debt or other contingent liabilities. We expect liquidity will likely remain very strong during the next two fiscal years.

Strong debt and contingent liability profile

In our view, Forest Hills' debt and contingent liability profile is strong. Total governmental fund debt service is 7.8% of total governmental fund expenditures, and net direct debt is 67.4% of total governmental fund revenue. Approximately 76.0% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor. Officials do not currently have any additional debt plans within the next two years.

Adequate pension and OPEB liability profile

The rating reflects our opinion of the following factors for the borough, including:

- We do not view pension liabilities as a source of credit pressure for Forest Hills, given strong plan funding status and affordable contributions relative to budget.
- We believe that the borough's costs related to other postemployment benefits (OPEBs) will likely escalate, but given the size of the liability relative to budget, we expect costs to remain affordable.

Forest Hills Borough participated in the following plans as of Dec. 31, 2020:

- Police Pension Plan: 102.2% funded with a net pension asset of $227,588.
- General Employees' Pension Plan: 111.8% funded with a net pension asset of $398,909.
- Police OPEB Plan: 0% funded with a net OPEB liability of $3.2 million.
- Non-Uniformed OPEB Plan: 0% funded with a net OPEB liability of $314,469.

Forest Hills' combined required pension and actual OPEB contributions totaled 9.2% of total governmental fund expenditures in 2020. Of that amount, 7.9% represented required contributions to pension obligations, and 1.3% represented OPEB payments. The borough made its full required pension contribution in 2020.

In the most recent year, contributions to both pension plans were more than our minimum funding progress metric, indicating strong funding progress. There is an actuarial plan in place to reach full funding for both plans and consistent contributions are expected due to the level-dollar amortization basis. The General Employees' Pension Plan was closed to new participants on Jan. 1, 2015. The plans are scheduled to be fully funded within seven and 10 years, for the Police and General Employees plans, respectively, which is stronger than S&P Global Ratings' guideline of 20 years to effectively pay down unfunded liabilities. With a discount rate of 7.0% for both plans, we believe there is risk of cost escalation due to market volatility.

Strong institutional framework

The institutional framework score for Pennsylvania nonhome-rule cities and all boroughs and townships is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- Credit Conditions: U.S. Regions' Economies Perk Up As The Pandemic's Impact Ebbs, April 16, 2021
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019